No. 04-885

Supreme Court, U.S.
FILED
AUG 22 2005
CLERK

In The Supreme Court of the United States

CENTRAL VIRGINIA COMMUNITY COLLEGE, VIRGINIA MILITARY INSTITUTE, NEW RIVER COMMUNITY COLLEGE and BLUE RIDGE COMMUNITY COLLEGE,

Petitioners,

v.

BERNARD KATZ, Liquidating Supervisor of the Bankruptcy Estate in *In re Wallace's Bookstores, Inc.*,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF IN SUPPORT OF RESPONDENT FOR *AMICI CURIAE* PROFESSORS SUSAN BLOCK-LIEB, ERWIN CHEMERINSKY, MARGARET HOWARD, KENNETH N. KLEE, JONATHAN C. LIPSON, RALPH R. MABEY, JEFFREY W. MORRIS, LAWRENCE PONOROFF AND ELIZABETH WARREN

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August 22, 2005

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INTEREST OF THE *AMICI CURIAE*[1]

Amici Curiae are law professors who teach and write in the areas of bankruptcy and constitutional law.[2] *Amici* are not predisposed to debtors or creditors or federal or state governmental bodies. They file this brief in support of the decision below because of the importance of establishing a uniform approach to the problem of State assertion of sovereign immunity in bankruptcy cases. That problem continues to plague fundamental aspects of the bankruptcy system even after this Court's important ruling in *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004) ("*Hood II*"), *affirming on other grounds Hood v. Tennessee Student Assistance Corp. (In re Hood)*, 319 F.3d 755 (6th Cir. 2003) ("*Hood I*").

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[1] Pursuant to Rule 37 of the Rules of the Supreme Court of the United States, the *amici* file this brief with the written consent of all parties, which are submitted herewith. No counsel for a party authored this brief in whole or in part. No person or entity including *amici* or their counsel made a monetary contribution for the preparation or submission of this brief; it has been prepared *pro bono*.

[2] Susan Block-Lieb is a Professor of Law at Fordham University Law School. Erwin Chemerinsky is the Alston & Bird Professor of Law and Political Science, Duke University School of Law. Margaret Howard is Law Alumni Association Professor of Law at Washington & Lee University. Kenneth N. Klee is a Professor of Law at the University of California at Los Angeles School of Law. Jonathan C. Lipson is an Associate Professor of Law at Temple University, James E. Beasley School of Law. Jeffrey W. Morris is the Samuel A. McCray Chair in Law at the University of Dayton School of Law. Ralph R. Mabey is an adjunct professor and senior lecturer at the J. Reuben Clark Law School, Brigham Young University. Lawrence Ponoroff is Dean and Mitchell Franklin Professor of Law at Tulane Law School. Elizabeth Warren is the Leo Gottlieb Professor of Law at Harvard Law School.

SUMMARY OF ARGUMENT

Amici support the argument made by Respondent Katz on behalf of the bankruptcy estate of Wallace's Bookstores, Inc. ("Wallace's"). This brief points out fundamental differences between the Bankruptcy Code and other statutes at issue in the Court's recent sovereign immunity opinions, and explains the analytical and practical impact of these differences. The brief further describes the intersection of preference law and claims determination under the bankruptcy court's *in rem* jurisdiction. Claims are to be disallowed until a transfer avoidable as a preference is recovered and offset by preference claim amounts, whether or not a proof of claim is filed, as a matter of the bankruptcy court's *in rem* claims adjudication. An order of avoidance is distinct from an order for recovery of an avoided transfer. An order avoiding a preference has preclusive effects on a subsequent recovery action, however, and avoidance and recovery should be litigated together against States, as they are with other preference defendants, including because there is no alternative means for actual recovery of the funds for distribution to creditors.

Second, federally-created bankruptcy estates should be deemed federal entities, unrestricted by sovereign immunity when pursuing rights integral to their statutory functions. These federally-created estates could recover preferences regardless of the scope of *in rem* jurisdiction.

Finally, *amici* explain that the American people abrogated state sovereign immunity when ratifying the Constitution. The Bankruptcy Clause, Article I Section 8, does not merely grant Congress power with respect to bankruptcy, but further expressly codifies the intention to have one uniform bankruptcy law enforceable in every State. This uniformity principle is not a limitation on

federal legislative power, but, to the contrary, demands recognition of Congress' power as one that extends beyond superseding inconsistent state legislation and enables federal bankruptcy orders to bind and be enforceable against States. Several reasons for this conclusion are given, including the historical need for federal discharge orders to be enforced against state debtors' prisons by writs of *habeas corpus*. This would have conflicted with principles of state sovereign immunity but for the constitutional abrogation.

ARGUMENT

I. Bankruptcy Laws Apply and Are Enforced Differently From Other Article I Laws, Requiring a Different Analysis of Sovereign Immunity.

The Bankruptcy Clause, the Bankruptcy Code, and the unique nature of bankruptcy litigation distinguish this case from other sovereign immunity cases decided by this Court. The Virginia Institutions and their *amici* argue that the Bankruptcy Code is no different from any other Article I legislation, and accordingly the Court's *Seminole Tribe* rejection of *Union Gas* and the *Atascadero* dissent means that the Constitution alienated only the power to legislate, not the power to enforce bankruptcy laws. *Seminole Tribe v. Florida*, 517 U.S. 44 (1996); *Pennsylvania v. Union Gas Co.*, 491 U.S. 1 (1989); *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 277-78 (1985). None of those cases, however, construed the Bankruptcy Clause.

Wallace's argument here differs from the decision in *Union Gas* and the *Atascadero* dissent because, like Hamilton's analysis in THE FEDERALIST NOS. 32 and 81, it hinges on the specific text of the particular constitutional provision involved, *i.e.*, the Bankruptcy and Naturalization

Clause. The Court has not previously ruled on this analysis, which is limited to this clause, and does not apply to other general Article I clauses such as the Commerce Clause. Unlike the other clauses considered in this Court's abrogation jurisprudence, the Framers of the Constitution expressly emphasized here the need to "establish" bankruptcy law that is "uniform .... throughout the United States." Reinforcing this point, they coupled the Bankruptcy Clause with the Naturalization Clause, another federal power demanding uniform provisions and enforcement.

Moreover, bankruptcy statutes are different in two particularly compelling ways from the tax, commerce and other Article I laws addressed in the Court's recent sovereign immunity cases. First, bankruptcy representatives acting as fiduciaries of bankruptcy estates are not private parties. They are federally designated representatives of federally-created bankruptcy estates, marshaling assets for the benefit of each estates' creditors, and distributing estate assets to those creditors once respective legal entitlements are determined. As noted in section III of this brief, the Eleventh Amendment does not bar suits by federal entities exercising statutory rights fundamental to their functioning.

Second, the substantive provisions of bankruptcy statutes are not regulatory laws and do not apply to the populace at large, nor do they mandate or proscribe any action in the course of everyday affairs. Bankruptcy laws apply only in conjunction with *in rem* bankruptcy cases. The federal government supplies the forum and standards for resolution of issues concerning all bankruptcy estates. Laws enacted under *other* Article I powers are enforceable by federal authorities, so that prevention of suits by private parties does not exempt States from compliance altogether. Bankruptcy preference causes of action, in

contrast, like the ancillary bankruptcy provisions of the automatic stay and the discharge, are enforceable only by representatives of bankruptcy estates and only in the context of specific bankruptcy cases; they are not enforceable by United States Attorneys or federal agencies filing lawsuits for injunctive or declaratory or other relief against businesses or individuals or a State. If federally designated representatives of bankruptcy estates cannot enforce such bankruptcy law provisions when acting in specific debtors' bankruptcy cases, then no one can.

Certainly, the Framers of our Constitution expected that bankruptcy laws, like other federal laws, would be enforceable. *See Railway Labor Executives' Ass'n v. Gibbons*, 455 U.S. 457, 472 (1982) ("The Framers sought to provide Congress with the power to enact uniform laws on the subject enforceable among the States"). This Court has recognized that state sovereign immunity does not mean that States cannot be compelled in court to comply with federal statutes. *See, e.g., Board of Trustees v. Garrett*, 531 U.S. 356, 374 n.9 (2001) (Americans With Disabilities Act could not be the subject of individual lawsuits against States but was still enforceable against States in federal court by federal government); *Alden v. Maine*, 527 U.S. 706, 755-56 (1999) (Fair Labor Standards Act; same). In Bankruptcy Code cases, a specific bankruptcy estate's designated representative is the arm of the federal government to enforce federal law.

Federal bankruptcy law must not be construed so restrictively as to deny a forum for recovery of assets transferred to States as preferred creditors on the eve of bankruptcy. Where there is a federal right, there must ordinarily be a remedy to enforce that right. *Marbury v. Madison*, 1 Cranch 137, 162 (1803); *see Idaho v. Coeur d'Alene Tribe of Idaho*, 521 U.S. 261, 271 (1997) (recognizing "the principle

that the plan of the convention contemplates a regime in which federal guarantees are enforceable so long as there is a justiciable controversy. THE FEDERALIST NO. 80, p. 475 (C. Rossiter ed. 1961 (A. Hamilton) ("[T]here ought always to be a constitutional method of giving efficacy to constitutional provisions")).

Bankruptcy law is enforceable through the orders of the federal court having jurisdiction over the bankruptcy estate, because the Framers of the Constitution expressly delegated that sovereign power to the federal government; because the federally-created bankruptcy estate is exercising powers integral to its functions, and because bankruptcy jurisdiction is *in rem*.

II. The Bankruptcy Court Has *In Rem* Jurisdiction Over Preferential Transfers.

A. Resolution of Preferences Is Integral to Collection and Distribution of the *Res*.

This Court affirmed *Hood I* by analyzing the *in rem* nature of bankruptcy cases. *Hood II*, 541 U.S. at 440-41. Preference avoidance is an integral part of claims allowance, which is a fundamental *in rem* determination.

The bankruptcy estate created upon the filing of a bankruptcy case includes causes of action created under the Bankruptcy Code to avoid and recover assets preferentially transferred to creditors pre-filing that result in unequal creditor treatment. 11 U.S.C. §§ 541(a)(1) (all legal and equitable interests in property as of the commencement of the case), 547 (preference cause of action as of commencement of the case). Further, property "that would have been part of the estate had it not been transferred before the commencement of the bankruptcy" is "property of the debtor" that can be recovered and become

"property of the estate." *Begier v. Internal Revenue Service*, 496 U.S. 53, 58 (1990); 11 U.S.C. §§ 541(a)(3) (interest in property recovered under 550), 547 (avoidance of transfers), 550 (to extent of avoidance, recovery of transferred property or its value). The district court, and by referral the bankruptcy court, has exclusive jurisdiction over "all of the property, wherever located, of the debtor as of the commencement of the case" and of "property of the estate." 28 U.S.C. § 1334(e); 28 U.S.C. § 157(a). There is no carve-out for property of the debtor in the possession of a State.

The bankruptcy court's *in rem* jurisdiction encompasses matters relating to claims allowance, including whether the claim is subject to offset or recoupment, which must be resolved in order to allocate property of the estate. *See Hood II*, 541 U.S. at 448; *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947). Determining the allowed amount of a claim entails determining the amount of the bankruptcy estate's offsetting claims or recoupment defenses. *Ossen v. Department of Social Servs. (In re Charter Oak Assocs.)*, 361 F.3d 760, 769 (2d Cir.), *cert. denied*, 125 S. Ct. 408 (2004). Further, claims are outright disallowed if the creditor received a preferential or otherwise avoidable transfer until that transferred property is surrendered to the estate. 11 U.S.C. § 502(d); *see Katchen v. Landy*, 382 U.S. 323, 330 (1966). Thus, whether or not debtor-transferred property is recovered and becomes property of the estate, the transfer may be avoided and the transferee's claim disallowed. 11 U.S.C. §§ 550, 547, 502(d).

A claim may be disallowed even if no proof of claim is filed, including by reason of an avoidable transfer. When a bankruptcy petition is filed, the debtor is obligated to file a schedule of creditors and claim amounts, and is required to designate whether the claims are disputed. 11 U.S.C. § 521(1). Creditors are nonetheless obliged to file proofs of

claim in a chapter 7 case in order to share in a distribution, but in a chapter 9 or 11 case, a proof of claim is deemed filed if the claim is scheduled by the debtor as liquidated, undisputed and not contingent. 11 U.S.C. §§ 502(a), 925, 1111(a); Bankruptcy Rules 3002, 3003. The debtor or trustee may file a proof of claim for a creditor with notice to that creditor, and should do so if a creditor is not listed to enable fair and complete treatment. 11 U.S.C. § 501(c); Bankruptcy Rule 3004; *see Ex parte Christy*, 44 U.S. 292, 315 (1845) ("creditors" are not limited to those who come into court and file claims, but include all present subsisting claims upon the bankrupt's estate); *City of New York v. New York, N.H. & H.R. Co.*, 344 U.S. 293, 296-97 (1953) (known creditor entitled to specific notice of bankruptcy proceeding affecting its lien for order to be binding).

If a distribution is to be made, the trustee is duty-bound to object to allowance of any improper claim. 11 U.S.C. §§ 704(5), 1106(a)(1), 1302(b)(1); *Gardner*, 329 U.S. at 573 (claim objection process is "of basic importance in the administration of a bankruptcy estate" to avoid diluting legitimate claims). An avoided transfer is then preserved for the benefit of the estate. 11 U.S.C. § 551.

B. Bankruptcy Courts Should Be Able to Require Recovery of Avoided Transfers Without State Consent.

Claim disallowance based on receipt of an avoidable transfer is clearly an *in rem* proceeding, the effect of which a State as a creditor cannot escape through an assertion of sovereign immunity. *See Hood II*, 541 U.S. at 448. States are creditors in the vast majority of bankruptcy cases, with claims based on contract, taxation, accidents with state-operated vehicles, and the like. Payments to States

on such claims within 90 days of bankruptcy is common. Avoidance of transfers through claim allowance procedures can thus be accomplished in most cases, but recovery of such transfers is nonetheless critical to equality of distribution and to discouraging creditor favoritism. It is also critical to prevent precipitous creditor actions that would dismember an estate and force a debtor into bankruptcy. *See Begier*, 496 U.S. at 58. Creditors who are concerned that their debtors will make payments to a State would have a strong incentive to initiate bankruptcy cases or take action that would force debtors to file bankruptcy petitions.

The problem of voidable preference payments to States is significant. As this Court noted in *Gardner* in the context of tax liens,

> If the reorganization court lacked the power to deal with tax liens of a State, the assertion by a State of a lien would pull out chunks of an estate from the reorganization court and transfer a part of the struggle over the corpus into tax bureaus and other state tribunals. That would not only seriously impair the power of the court to administer the estate . . . It would fly in the teeth of . . . reorganization court 'exclusive jurisdiction of the debtor and its property wherever located.'

329 U.S. at 577. Indeed, the assertion of sovereign immunity is exacerbated when the State possesses the property at issue instead of taking only a lien against it, as in *Gardner*, because States can resist efforts to recover the property in both state and federal courts, thereby hobbling fundamental bankruptcy goals. *See Printz v. United States*, 521 U.S. 898, 925 (1997) (federal government may not compel States to implement or enforce federal laws); *Alden*, 527 U.S. at 754 (state sovereign immunity extends to suits under federal law brought in state courts); *compare Coeur*

d'Alene Tribe of Idaho, 521 U.S. at 274 (*Ex parte Young* case in which the State possessed land that was an essential attribute of its sovereignty, in contrast to funds transferred on the eve of bankruptcy that are "property of the debtor," and the state court was open to hear and determine the case, unlike preference actions in which state court availability is not assured).

The Virginia Institutions and their *amici* essentially take the position that they can evade any preference exposure whenever they assert sovereign immunity from suit. The *amici* brief of the American Association of State Colleges and Universities et al. asserts that Wallace's preference claims "might have been allowed" if it had only followed procedures of Va. Code Ann. § 2.2-815.A, and that "all other states" have similar procedures for dealing with claims arising out of contracts for goods and services with state agencies or instrumentalities. (Amer. Ass'n Br. at 22 and n.21). The cited Virginia statute has been held not to constitute a waiver of the State's Eleventh Amendment immunity, however. *McConnell v. Adams*, 829 F.2d 1319, 1329 (4th Cir. 1987), *cert. denied*, 486 U.S. 1006 (1988) *citing Edelman v. Jordan*, 415 U.S. 651, 673 (1974). It has been held not to justify suits in federal or state court against Virginia alleging rights under federal statutory law. *Commonwealth v. Luzik*, 259 Va. 198, 207-09, 524 S.E.2d 871 (2000) (Fair Labor Standards Act). Such intermittent waiver statutes cannot be relied upon to authorize preference recovery lawsuits in state court.

The waiver statutes cited by the *amici* illustrate that States have waived sovereign immunity in many respects. If nothing else, this shows that being sued is not nearly the affront they proclaim. On the other hand, States' contention that they can pick and choose when to comply with federal bankruptcy law creates serious problems for

the bankruptcy system. Logically, it means they would be exempt from the automatic stay, property turnover requirements, and other similar Bankruptcy Code obligations. Among other problems, this would give the States unfair leverage *vis-à-vis* other creditors, including the federal government, which is also a creditor in most bankruptcy cases, often for tax liability, and is bound by bankruptcy court rulings. *See* Jonathan C. Lipson, *Fighting Fiction with Fiction – The New Federalism in (a Tobacco Company) Bankruptcy*, 78 WASH. U.L.Q. 1271, 1330 (2000) (arguing that recognizing sovereign immunity destabilizes negotiations in bankruptcy).

Once the bankruptcy court exercises its *in rem* authority to avoid a transfer and to disallow a claim after notice to the creditor, the "normal rules of *res judicata* and collateral estoppel apply," so that "once a bankruptcy court has dealt with the preference issue nothing remains for adjudication" in a subsequent action to recover the asset. *Katchen*, 382 U.S. at 334. As the Court recognized in *Katchen*, to require a second action in such circumstances to recover the transferred asset "would be a meaningless gesture." *Id.* Either the scope of *in rem* jurisdiction should be recognized as extending to recovery of preferences, as Wallace's advocates, or States should be held subject to bankruptcy jurisdiction under the federally-created entity or Plan of the Convention analyses described below. Certainly, if a State appears and litigates the avoidability of a payment it received, it should be held to have waived sovereign immunity for purposes of a proceeding to recover the avoided amount under Bankruptcy Code § 550, even if it did not file a proof of claim.

III. State Sovereign Immunity Is Inapplicable to a Federally-Created Bankruptcy Estate Implementing Bankruptcy Code Provisions.

A. The Eleventh Amendment Does Not Preclude Suits Against States by the United States and Federally-Created Entities.

Congress may authorize the United States to institute legal proceedings against States to protect citizens' federally-guaranteed rights. *United States v. Mississippi*, 380 U.S. 128, 140 (1965). A federally-created entity may likewise sue a State in federal court to enforce federally-created rights without Eleventh Amendment restrictions. *Osborn v. Bank of U.S.*, 22 U.S. 738, 825, 870-71 (1824).

In *Osborn*, the Court found no error in a judgment directing restitution of $98,000 and repayment of an additional $2,000 taken as taxes from the Bank and held by the Ohio State Treasurer in a separate bank account, in which he had no individual interest. *Id.* at 740-41, 870-71. The Court noted that the State was not a named party to the suit and that the State could defend as if it were a party of record. *Id.* at 857, 870. Chief Justice Marshall explained that the Bank of the United States was not a private corporation whose principal object was individual trade and profit, but instead was created for public and national purposes although capable of transacting private as well as public business and trading for its own advantage. *Id.* at 860. Importantly, the rights it asserted in the litigation were founded on and integral parts of the law that created the Bank. *Id.* at 825-27. The State could not prevent restitution to a federal entity in such circumstances. *Id.* at 871.

This Court later held that the mere fact that a corporation was created by Congress would not enable the

entity to sue a State in federal court asserting a state law cause of action that was not an integral part of the law that created the federal entity. *Smith v. Reeves*, 178 U.S. 436, 437, 446 (1900). As in *Osborn*, the suit was nominally against the State Treasurer, but the parties sought a refund of taxes held in the state treasury. *Id.* at 439-40. The determinative factor in the Court's holding was not the Treasurer's capacity, but rather that the State could require that a state law claim, not touching upon any federal right, be litigated in state court, where the federal entity had an adequate remedy. 178 U.S. at 441, 445.

When suing to recover preferentially-transferred "property of the debtor" for equitable sharing among all creditors of the estate, the authorized representative of a bankruptcy estate is "exactly the same as that of the Bank of the United States" pursuing "a right arising under a law of the United States. . . . " *Claflin v. Houseman*, 93 U.S. 130, 135 (1986); *see Ex parte Christy*, 44 U.S. at 312. As with *Osborn*, preference causes of action are an integral part of the law that creates federal bankruptcy estates. They accrue only upon the filing of a bankruptcy petition, are a fundamental part of the marshaling of the federally-created bankruptcy estate, and benefit only creditors of that bankruptcy estate. If there are sufficient funds in the estate for all creditors to be paid in full, the cause of action does not come into existence. 11 U.S.C. § 547(b)(5). For these reasons *Osborn*, not *Smith*, is apt and controls this case.

B. Bankruptcy Estates May Assert Preference Claims Against States.

Bankruptcy estates act through representatives authorized by the Bankruptcy Code and court. The representative usually is a trustee, appointed by, subject to

removal by, and supervised by the bankruptcy court and by the United States Trustee, who in turn is appointed by, subject to removal by, and supervised by the United States Attorney General. 28 U.S.C. §§ 582, 586(a)(1), (3), (c), (d); 11 U.S.C. §§ 701, 1104. A trustee can only be compensated in an amount approved by the bankruptcy court and cannot engage professionals without court approval; the court also has authority to remove the trustee from a particular case for cause. 11 U.S.C. §§ 324(a), 326(a), 327(a). The estate representative may be a court-appointed liquidator under a confirmed reorganization plan, as in Wallace's, holding the rights and powers of a bankruptcy trustee. 11 U.S.C. § 1123(b)(3)(B). In chapter 11 cases, the representative may be the debtor in possession, where the debtor is empowered with rights and performs functions and has duties of a trustee, rather than acting in a private capacity. 11 U.S.C. § 1107. The Bankruptcy Code expressly authorizes the representative of the estate to sue and be sued. 11 U.S.C. § 323; 28 U.S.C. § 1334.

Whoever the authorized representative, the person acts on behalf of a federally-created bankruptcy estate that serves as a mechanism to transfer a debtor's assets to creditors. *See* Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 814-30 (2000). The debtor is not a "new legal person" but the "estate" is a new *res*, under new control of a trustee and court, with creditors becoming new beneficial interest holders, and with new legal rights and responsibilities. *National Labor Relations Board v. Bildisco & Bildisco*, 465 U.S. 513, 528-29 (1984); *Katchen*, 382 U.S. at 336; *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 451-54 (D. Utah 1998).

While not at issue in this case, jurisdiction of federal district courts to adjudicate state law collection suits brought by bankruptcy estates depends on those estates being federal entities. There is no diversity of citizenship or ordinary federal question jurisdiction in such cases; they depend on the relationship of the state lawsuit to the bankruptcy estate. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 72 n.26 (1982); *Williams v. Austrian*, 331 U.S. 642, 658-60, 664 (1947). Further, the bankruptcy trustee or other estate representative is an officer of the appointing court entitled to quasi-judicial immunity for actions integrally related to the adjudication of the bankruptcy case, who may be sued for such actions only with leave of the appointing court. *In re Castillo*, 297 F.3d 940, 947-53 (9th Cir. 2002) (analysis of bankruptcy trustees' immunity from common law to the present); *Matter of Linton*, 136 F.3d 544, 545 (7th Cir. 1998) ("a trustee in bankruptcy is working in effect for the court that appointed or approved him, administering property that has come under the court's control by virtue of the Bankruptcy Code"); *see also In re Barman*, 252 B.R. 403, 412-13 (Bankr. E.D. Mich. 2000) (bankruptcy trustee is "state actor" for Fourth Amendment purposes when inspecting a debtor's residence to look for estate assets).

The bankruptcy estate (and with respect to discharge also the individual debtor) constitutes the *res* that supports *in rem* jurisdiction. *See Hood II*, 541 U.S. at 440-41; *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 191-92 (1902). Through its representative, the bankruptcy estate may pursue federally-created preference, turnover, stay violation and other causes of action, as well as state law claims. 11 U.S.C. §§ 547, 542. Preference claims are core proceedings arising under the Bankruptcy Code, as are estate counterclaims against creditor claimants and

creditor claim determinations. 28 U.S.C. §§ 157(b)(2)(B), (C), (F). The preference claims at issue here did not exist before the bankruptcy case was filed, and are fundamental components of the collection and distribution of bankruptcy estates.

As previously explained, unlike the tax, commerce and other Article I laws resolved in the Court's recent sovereign immunity cases that are enforceable by federal authorities, bankruptcy causes of action, including preference actions, are enforceable only by the estate representative designated by the court. 11 U.S.C. § 547(b); *see Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 7-9 (2000). Claim allowance proceedings can be commenced by any party in interest, but they, too, arise only in the context of specific bankruptcy cases, and cannot be litigated by United States Attorneys or federal agencies in state court or non-bankruptcy federal court suits. 11 U.S.C. § 502(a). The United States Trustee, appointed by the Attorney General, is a party in interest in bankruptcy cases who can review and monitor them, but the United States Trustee can sue to assert preference and similar rights only when appointed to serve as a trustee in a specific case. 28 U.S.C. § 586. Unless estate representatives can enforce such bankruptcy law causes of action on behalf of specific debtors' bankruptcy estates, no one can do so.

IV. The American People Allocated Bankruptcy Jurisdiction to the Federal Government to Bind State Authorities.

These *amici* join and support the briefs filed by Wallace's and by noted legal historian *amicus* Prof. Bruce Mann in their analysis of the historical framework in which the Bankruptcy Clause was drafted, and its import

in interpreting that clause. An article by Hon. Randolph J. Haines, *The Uniformity Power: Why Bankruptcy Is Different*, 77 AM. BANKR. L.J. 129, 139, 174 (2003) ("Haines"), also provides a background explanation of the relevant issues. This brief expands on three points referenced in the briefs and the Haines article with respect to the surrender of immunity in the Plan of the Convention.

First, however, *amici* respond to the argument of the Virginia Institutions and their *amici* that, in effect, the Court has already decided these arguments against Wallace's. This Court has never, in *Seminole Tribe* or elsewhere, addressed the Plan of the Convention analysis for the surrender of state sovereign immunity in bankruptcy.[3] This Court has, however, repeatedly recognized that while Congress cannot abrogate sovereign immunity whenever it has legislative authority, *e.g.*, in Article I, the States surrendered some portions of their sovereignty through the Constitution in the rare circumstances referenced in FEDERALIST 32. The majority opinion in *Seminole Tribe* itself twice acknowledges that the States enjoy immunity except where there was a "surrender of this immunity in the plan of the convention." *See Seminole Tribe*, 517 U.S. at 68 & n.13. *See also Alden*, 527 U.S. at 713 (referring to retention of sovereignty by States "except as altered by the plan of the convention"); *Blatchford v. Native Village of Noatak*, 501 U.S. 775, 779 (1991) (recognizing express consent to suit, consent through the Plan of the Convention, and abrogation as grounds for loss of immunity); *Hans v. Louisiana*, 134 U.S. 1, 13 (1890) (discussing

[3] *See Hood II*, 541 U.S. at 454, where the phrase "[e]ven if we were to hold that Congress lacked the ability to abrogate sovereign immunity under the Bankruptcy Clause" indicates that the Court had not already so held in *Seminole*.

immunity as an inherent attribute of state sovereignty "[u]nless, therefore, there is a surrender of this immunity in the plan of the convention").

This Court has also recognized that the States surrendered their immunity as to suits against entities created under the Interstate Compact Clause, Article I, section 10, clause 3 of the Constitution. *See Hess v. Port Auth. Trans-Hudson Corp.*, 513 U.S. 30, 41-42 (1994). The Court found that the Port Authority could be sued in federal court because, as "part of the federal plan prescribed by the Constitution, the States agreed to the power sharing, coordination, and unified action that typify Compact Clause creations." *Id.*; *see also id.* at 56 (J. O'Connor, dissenting) ("the crux of the Court's analysis rests on its apparent belief that the States ceded their sovereignty in the interstate compact context in the plan of the convention").

A. The Bankruptcy Clause Was Intended to Encompass Immunity From Suit.

Hamilton explained that the Plan of the Convention included a surrender of state sovereign immunity where the Constitution "granted an authority to the Union, to which a similar authority in the States would be absolutely and totally *contradictory* and *repugnant*." *See* THE FEDERALIST NO. 32 at 192 (Robert Scigliano, ed. 2000) (emphasis in original). As an example of this type of federal authority, Hamilton cited to the power over naturalization, which appears together with the federal bankruptcy power in the same constitutional clause.

Today, to speak of state immunity from bankruptcy as "absolutely and totally contradictory and repugnant" may seem a bit extreme. The Framers of the Constitution,

however, had a different perspective. In 1789, a discharge of debts was profoundly bound up with the powers of the sovereign, rather than merely an issue between individual debtors and their creditors.

First, at the time of ratification, a bankruptcy discharge meant a release from debtors' prison, not merely a fresh financial start. "The only consistency among debt laws in the eighteenth century was that every colony, and later every state, permitted imprisonment for debt – most on *mesne* process, and all on execution of a judgment." Bruce H. Mann, *Republic of Debtors: Bankruptcy in the Age of American Independence* 79 (Harvard U. Press 2002); *see also* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 12 (1995). Early colonial and state insolvency relief laws were brief and limited, providing for release from imprisonment, often without a discharge from debt, and in some instances either assigning property to creditors or even binding debtors in service to their creditors. Mann at 51-53, 79-80, 177-79. The first federal bankruptcy act, enacted in 1800 following ratification of the Constitution, provided for a discharge, not only of debts but also of the person of the debtor from debtors' prison. *See id.*; Bankruptcy Act of 1800, Sess. I, Ch. 19, §§ 34, 38.

Thus, the creation of a discharge by federal statute directly conflicted with the sovereign authority of the States to punish and imprison debtors, and to impose their own terms for release. An effective, and uniform, federal law would have been impossible if the States could not be bound by the federal discharge, as only the States could give it effect by releasing debtors from their prisons. Legislative preemption alone would have been insufficient to bind States to obey bankruptcy discharge orders. Moreover, state action alone, without the unifying influence of federal

authority, would be unable to create a uniform system for the discharge of debts. State authority in this respect is necessarily limited both by the contracts clause of the United States Constitution and by the States' limited territorial authority. *See Ogden v. Saunders*, 25 U.S. (12 Wheat) 213 (1827) (discussing nature of state and federal authority over bankruptcy issues); *Sturges v. Crowninshield*, 17 U.S. (4 Wheat) 122 (1819) (same).

Second, in ratifying the Constitution, the States were also aware of the diversity of existing state approaches to bankruptcy:

> Prior to the drafting of the Constitution, at least four States followed the practice of passing private Acts to relieve individual debtors. Given the sovereign status of the States, questions were raised as to whether one State had to recognize the relief given to a debtor by another State. Uniformity among state debtor insolvency laws was an impossibility and the practice of passing private bankruptcy laws was subject to abuse if the legislators were less than honest. Thus, it is not surprising that the Bankruptcy Clause was introduced during discussion of the Full Faith and Credit Clause. The Framers *sought to provide Congress with the power to enact uniform laws on the subject enforceable among the States.*

Gibbons, 455 U.S. at 472 (1982) (internal citations omitted) (emphasis added); *see* Mann at 51-53, 55, 59-61, 79, 177-80, 183. If the States' immunity had not been surrendered, the Constitution's grant of power to Congress to create a uniform bankruptcy system, "*enforceable among the States*," would have been meaningless.

Third, when the Constitution was drafted and ratified, delinquent debt was extensive and held across state borders. The economic impact of wars, accompanied by

disruption of foreign trade, post-war contractions, and consequent commercial risks, and the vagaries of business in an era before insurance, had led to economic declines and failures by merchants of integrity. *E.g.*, Mann at 55-57, 83-84, 102, 169-71, 176-77. The indebtedness was public as well as private, in part because States as well as Congress had issued bills of credit and loan certificates to purchase supplies and pay soldiers on the promise of paying interest or accepting them in payment of taxes. *Id.* at 169-70. Speculation in public debt by investors was rampant. *Id.* at 175-76.

Key delegates to the constitutional convention were aware of this, and aware of pending issues of applying state insolvency and bankruptcy rules to debtors and creditors who lived in different States, and the value of addressing the issue on a national level. *Id.* at 185. One of the Pennsylvania lawyer delegates to the convention had a pending case in which he was defending a debtor who had received a Maryland discharge, then been imprisoned by a Pennsylvania creditor for unpaid debt, in which he was arguing the obligation of one State to recognize another State's discharge. *Id.* at 184-85. He had recently received a decision for another client holding that under the Articles of Confederation, a discharge by a New Jersey court shielded a debtor from arrest in that State, but did not bind Pennsylvania courts or discharge him from being imprisoned in Pennsylvania for another debt. *Id.* at 184.

Records of ratification debates in the States also include recognition by at least some of the participants that the purpose of the constitutional provision empowering Congress to establish uniform laws on bankruptcy was for a bankruptcy determination "when conformed to in one state" to be "effectual to secure the debtor throughout the union." *Id.* at 186 n.35 (citing a delegate to the Connecticut ratifying

convention, Samuel Holden Parson to William Cushing, Jan. 11, 1788, in DHRC, 3:572).

The impact of uniformity was likewise recognized by Anti-federalist writers. "The anonymous 'Federal Farmer' argued that even if uniform bankruptcy laws were practicable – which he thought unlikely given 'the extent of the country, and the very different ideas of the different parts in it, respecting credit, and the mode of making men's property liable for paying their debts' – a federal bankruptcy power was nonetheless an interference 'with the internal police of the separate states, especially with their administering justice among their own citizens.'" *Id.* at 187.

Fourth, bankruptcy was tied to state sovereignty because of its relationship to state policy and economic power. The first federal bankruptcy act provided relief only to merchants or traders, and was opposed by agrarian and plantation interests. *See* Mann at 216-19; Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 Am. Bankr. L.J. 325, 346 (Spring 1991); Charles Warren, *Bankruptcy in United States History* at 18-19 (1935). Continuing opposition resulted in the repeal of the first act in 1803, only three years after it was passed. *See* Tabb, *History of the Bankruptcy Laws*, *supra*, at 15; Warren, *supra*, at 21.

Thomas Jefferson himself opposed federal bankruptcy legislation because he perceived the proposed laws as pro-merchant and anti-agrarian. Jefferson was particularly concerned that federal law would eliminate some of the protections provided to debtors under existing state laws. *See* Warren at 16; Mann at 197. For example, Virginia state law at the time protected freehold lands from execution. *See id.* As Jefferson recognized, the federal bankruptcy power superseded the States' control of lands

within their own borders, a direct affront to their sovereignty.

Through the Bankruptcy Clause, the people granted the federal government the authority to control citizens, contracts and commerce that would otherwise have been under state control. The people even handed the federal government the keys to state prisons when it came to bankrupt debtors. This is the context in which this Court should analyze state sovereign immunity from suit on bankruptcy claims.

B. Bankruptcy Uniformity Is Not Merely Geographical, but it Restricts Sovereign Immunity as Well.

The Virginia Institutions and their *amici* contend that the uniformity provision in the Bankruptcy Clause is a limitation on the power of Congress, rendering it less potent than other Article I powers, particularly because it does not include a "dormant" preclusion of state laws in the absence of a federal bankruptcy law and national bankruptcy statutes were so difficult to enact and retain. Rather, the breadth of the effect of a national bankruptcy law demonstrates why the political hurdles referenced in section IV A of this brief loomed so large.

The Court has interpreted the Bankruptcy Clause uniformity language in several contexts, none bearing on sovereign immunity, except to the extent that Chief Justice Marshall observed in the first interpretation of the Bankruptcy Clause that "[t]he peculiar terms of the grant [of bankruptcy power] certainly deserve notice" because "Congress is not authorized merely to pass laws, the operation of which shall be uniform, but to establish

uniform laws on the subject throughout the United States." *Sturges*, 17 U.S. (4 Wheat.) at 193-94.

In *Vanston Bondholders*, Justice Frankfurter said that one type of uniformity was geographic. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 172 (1946) (the uniformity provision "is a requirement of geographic uniformity") (Frankfurter, J., concurring). But he did not foreclose other types of uniformity, and the majority in *Vanston Bondholders* reasoned that federal courts must enforce federal bankruptcy law, not just treat state laws uniformly. In *Moyses*, the Court held that uniformity permitted debtors to use exemptions that varied by State, which it found to be consistent with a concept of geographic uniformity. *Moyses*, 186 U.S. at 190.

In *Gibbons*, however, the Court applied "uniformity" in a non-geographical context, and held that private bankruptcy bills applicable to a single debtor are prohibited. In so holding, *Gibbons* followed an earlier case holding that uniformity requires that the law be applied equally to all creditors and debtors. *Gibbons*, 455 U.S. at 469-71; *Blanchette v. Connecticut Gen. Ins. Corps.*, 419 U.S. 102, 160 (1974). If, as in *Gibbons*, uniformity means that all similarly situated debtors must be treated alike, the same should hold true for all similarly situated creditors – including States. *See* Lipson, *supra*, 78 WASH. U.L.Q. at 1335-36 (arguing that sovereign immunity "should not entitle States to become the ultimate 'holdouts'").

None of these cases holds that Congress is prohibited from adopting a bankruptcy law imposing even greater uniformity by forbidding a State or any other creditor from opting out. Haines at 163-64. The Virginia Institutions overlook the fact that the Bankruptcy Clause is found in Section 8 of the Constitution, "Powers of Congress," not

Section 9 on "Prohibited Powers." Haines at 167. Like the Necessary and Proper Clause, it is a grant of power instead of a limitation. *See McCulloch v. Maryland*, 17 U.S. 316, 419-20 (1819). When the Founding Fathers wanted to impose restrictive uniformity requirements, they did so, as illustrated by the uniformity language in the Constitution's taxing power provision. U.S. CONST. art. I, § 8, cl. 1 ("The Congress shall have Power to lay and collect Taxes . . . but all Duties, Imposts and Excises shall be uniform. . . ."). Likewise, when the Framers of the Constitution wanted to provide for legislative supremacy alone, they specified that whenever federal and state laws are inconsistent, federal laws supersede state requirements under the Supremacy Clause. U.S. CONST. art. VI, § 2.

The FEDERALIST PAPERS explain that there is a sovereign immunity aspect to the Bankruptcy Clause uniformity provision; it is not a superfluous restating of the Supremacy Clause. As this Court recognized in *Seminole Tribe*, Hamilton did not say that whenever Congress has legislative authority (*e.g.*, in Article I), it can abrogate sovereign immunity. Rather, Hamilton explained in FEDERALIST NO. 81 that this would happen only in the rare circumstances referenced in FEDERALIST NO. 32. He thus distinguished between general Article I powers where the Supremacy Clause would override States' reserved legislative authority and specific instances when state sovereignty was completely "alienated." FEDERALIST NO. 81. The naturalization powers he referenced, like the bankruptcy powers *found in the same clause*, require that States accede to federal authority. Madison explained that States could not make their own different decisions on qualifications for citizenship in the nation. FEDERALIST NO. 42. Likewise, States could not make their own different

decisions on whether a federally discharged debtor should be released from their state prisons, because, as Madison recognized, debtors and their property "may lie or be removed into different States," affecting the regulation of commerce and fraud. *Id.*

C. Bankruptcy Laws in Their Entirety Were Intended to Be Enforceable Against States.

The Virginia Institutions and their *amici* argue that the Framers of the Constitution never intended to authorize bankruptcy preference litigation against States, because bankruptcy laws of that era did not authorize suits of any kind against the government. The concept of preference liability existed, however. "There is no dispute that actions to recover preferential or fraudulent transfers were often brought at law in late 18th-century England." *Grandfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 43 (1989); *Schoenthal v. Irving Trust Co.*, 287 U.S. 92, 94 (1932); *see* Mann *amicus* brief.

Whether prior statutes authorized preference recoveries from the government is not the point, however, any more than whether debts held by governmental creditors were discharged under those laws. The critical point is that the concept of bankruptcy when the Constitution was ratified necessarily contemplated and intended to enforce federal rulings against state governments in the form of the discharge of debtors from state debtors' prisons. The current Bankruptcy Code gives debtors a "fresh start," free of various types of debt. *Perez v. Campbell*, 402 U.S. 637 (1971). In 1789, however, a bankruptcy discharge was integrally connected to the powers of the sovereign, rather than merely an issue between individual debtors and their creditors, because of debtors' prisons.

Importantly, the means for enforcement of the federal discharge in the first federal bankruptcy act was a writ of *habeas corpus* operating directly against state jailers in their official capacities. If the bankrupt debtor were arrested after discharge on account of a prepetition debt, any federal judge in the district or the judgment court could issue a writ of *habeas corpus* ordering the state jailer to discharge the bankrupt. Act of 1800 § 38; Haines at 178. This was a direct infringement on state sovereignty. Contrary to the premise of sovereign immunity that the king can do no wrong, the writ of *habeas corpus* permitted a court to determine whether the king (or State) in fact did wrong by imprisoning a citizen without legal cause under the court's legal standards. Haines at 182.

When the Constitution was written, the federal writ enforcing a discharge from state debtors' prison would have been understood as an invasion of state sovereignty. The writ was served on a state prison official, but could not have been justified under an *Ex parte Young* immunity exception. *Ex parte Young*, 209 U.S. 123 (1908). *Ex parte Young* was not decided for another 100 years, and the "fiction" on which it is based was discredited in the Constitutional era and did not provide a rationale for federal enforcement of a debtor's discharge against a state authority. *See Pennhurst State Sch. & Hosp. v. Halderman*, 465 U.S. 89, 114 n.25 (1984) (*Ex parte Young* authority-stripping theory a "fiction"). Justice Marshall held the opposite of *Ex parte Young*: When a state official was sued in his official capacity and had violated no law that would render him liable in a personal capacity, the State itself was considered a party on the record, and the federal court lacked jurisdiction under the Eleventh Amendment. *Governor of Georgia v. Madrazo*, 26 U.S. 110, 123-24 (1828).

Yet a federal discharge was enforced through *habeas corpus* as soon as the federal bankruptcy law – debated for years – finally was enacted in 1800. This was a new provision, absent from the English counterpart law, and needed because of the unique federal and state dual sovereigns in the United States. Haines at 178-79. Statutory federal *habeas* jurisdiction over state prisoners outside of bankruptcy was not enacted until 67 years after it was authorized under the first bankruptcy act of 1800. Haines at 191. Bankruptcy was thus the only context at that time in which a federal court could order a State to discharge a prisoner who had violated a state law.

That Congress, in 1800, was willing to take the dramatic, and at the time unprecedented, step of passing legislation directly cutting deeply into state sovereignty strongly suggests that the uniformity language of the Bankruptcy Clause was no accident and no casual, ambiguous, limiting principle. Rather, it was reflective of the understanding at the time that the needs of a uniform bankruptcy law "throughout the United States" would impinge on state sovereignty. The most sensible interpretation is that the Bankruptcy Clause was intended to overcome state sovereign immunity. *See Marsh v. Chambers*, 463 U.S. 783, 790 (1983) (express consideration and resolution of difficult constitutional issues by the First Congress provides contemporaneous and weighty evidence of the Constitution's meaning).

The conclusion to be drawn from history is that the concept of a uniform bankruptcy law is comparable to the uniform naturalization laws to which Hamilton referred in THE FEDERALIST. Under the Constitution's federal system, citizens were citizens of the nation. No state government could refuse to recognize a person's national citizenship, and no state government could imprison a bankrupt

person or refuse to recognize his bankruptcy discharge in the face of contrary federal law. For the States to be permitted to flout federal bankruptcy authority would have been "contradictory and repugnant" to the Constitutional scheme. Yet if this Court reverses the Court of Appeals for the Sixth Circuit, States will indeed be permitted to flout federal bankruptcy authority, and scuttle the uniformity power granted by the Constitution.

CONCLUSION

States as creditors have an enormous impact on bankruptcy cases and on the rights of both debtors and other creditors. States benefit when estate representatives recover preferences from other parties and distribute the proceeds equitably to all, but want a special dispensation from turning over preferential receipts themselves. If States are able to "opt out" of the federal bankruptcy system, that system is seriously threatened in a variety of ways, including:

- Impeding the fresh start promised by the Bankruptcy Code – one of the Code's "primary purposes" – when they opt out of automatic stay enforcement. *See, e.g., Perez*, 402 U.S. at 648 (1971).
- Frustrating fairness to creditors, and "a ratable distribution of assets among the bankrupt's creditors" – additional primary purposes of federal bankruptcy law. *Vanston Bondholders*, 329 U.S. at 161; *Gardner*, 329 U.S. at 577.
- Hampering the "orderly and expeditious" resolution of estates – yet another "fundamental purpose" of the bankruptcy system,

> *Irving Trust*, 288 U.S. at 333 – and allowing States to "pull out chunks of an estate from the reorganization court and transfer a part of the struggle over the corpus into . . . state tribunals," thus "seriously impair[ing] the power of the court to administer the estate." *Gardner*, 329 U.S. at 577.

Binding States as creditors to bankruptcy determinations of core issues in the *in rem* proceedings over bankruptcy estates is not only constitutional, but sound and appropriate. Once avoidance of a preferential transfer is determined by the federal court, precluding the necessary second step of actual recovery unless the State consents is unsound, frustrates federal law and fundamental legal policies by foreclosing a remedy for a federal statutory violation, and contravenes the intent of the Framers of the Constitution. This Court should affirm the Sixth Circuit's decision for the reasons set forth by Wallace's brief, by Professor Mann in his brief and scholarly work, and by this brief.

Respectfully submitted,

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